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No. 869.

IN THE

Supreme Court of the United States

OCTOBER TERM, 1962

SHELL OIL COMPANY, a corporation,
Petitioner,

v.

C. P. McKNIGHT and H. H. GREEN,
Respondents.

RESPONDENTS' REPLY TO PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

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NATURE OF THE CASE

This is a diversity action brought in the District Court of the Eastern District of Texas, by Petitioner, in which the issue was whether the Petitioner or the Respondents own and are entitled to the possession of the oil, gas and mineral leasehold estate, in and to a tract of 55.9 acres in Wood County, Texas, insofar as such leasehold covered the sub-surface horizons down to a depth of 6500 feet from the

surface. Petitioner's complaint sought to recover the leasehold as to all horizons. Respondents answered denying Petitioner's allegations of ownership of the lease as to all horizons, and by way of counter claim sued to recover the legal title and possession of the leasehold rights in the sub-surface horizons above a depth of 6500 feet from the surface, on the grounds the Court should construct a trust in favor of Respondents as to such "shallow rights" above the depth of 6500 feet.

The action was tried by the Court, without the intervention of a jury, none being requested, and the Court found the leasehold estate created by the lease (dated April 4, 1957) was owned by Petitioner as to all rights below a depth of 6500 feet, and was owned by Respondents as to the "shallow rights" above a depth of 6500 feet. In reaching this result, the Court found a constructive trust in favor of Respondents as to the leasehold rights above the depth of 6500 feet.

The district court made a full statement of its finding of fact, and conclusions of law, as shown by its Memorandum Decision, 204 F. Supp. 159 (set out in full in Appendix B at page 3a of the Petition for Writ of Certiorari). On appeal, the Court of Appeals affirmed the lower court by a *Per Curiam* opinion, stating: "We are in agreement with the decision reached by the district court and with the reasons assigned by it for its decision. The judgment is affirmed." As we see the case it poses no constitutional or federal questions. It involves only the application of local law (the law of Texas) to the facts.

What Is the Local Law Applicable to the Case?

Under the Rules of Decision Act of June 25, 1948 (28 U.S.C., Sec. 1652) the laws of Texas are to be regarded as the rule of decision in Civil Actions in the Courts of the

United States where they apply, and when no constitutional or Federal questions are involved.

The district court in finding and imposing a constructive trust, as set out in its Memorandum Decision, based its conclusions of law on the decision of the Texas Supreme Court in *MacDonald* v. *Follett*, 142 Tex. 616, 180 S.W.2d 334, 337 (1944) and the *Fitz-Gerald* v. *Hull*, 150 Tex. 39, 237 S.W.2d 256 (1951). These cases are the recognized, leading decisions in Texas on constructive trusts of the type involved in this case, and have been followed in numerous cases in the Supreme Court of the state, as well as in its Courts of Civil Appeals.

The basis for the establishment of a constructive trust, as set out, in *MacDonald* v. *Follett* and *Fitz-Gerald* v. *Hull*, is, briefly stated, that such trust is imposed to prevent unjust enrichment or undue advantage to one party, standing in a position of confidence and trust toward another, to the detriment of such other party, with respect to business or property in which the parties have become associated; and that it is immaterial whether the relation of confidence and trust existing between the parties is a technical or formal fiduciary relationship, or one growing out of an informal, social or personal relation.

In *MacDonad* v. *Follett* the relationship between the parties (joint ownership of leases or royalty) is denominated as a "status existing". In the opinion the Court stated it was not concerned with the exact relation between the parties, whether it be a co-tenancy, or otherwise, that what it sought to determine was whether a relation of trust and confidence existed between them.

Fitz-Gerald v. *Hull* rests primarily on *MacDonald* v. *Follett* to support the conclusion that a constructive trust could be imposed under the facts of the case. In addition

it emphasizes and amplifies the statement of the requisites of a constructive trust, quoting extensively from 54 Am. Jur., "Trusts", p. 173, Secs. 225-228, and from Restatement, "Restitution," p. 64, Sec. 160, *et seq.*, on the subject of "Constructive Trusts", stressing, in the language of 54 Am. Jur., Sec. 225, p. 173:

> "While a confidential or fiduciary relationship does not in itself give rise to a constructive trust, an abuse of confidence rendering the acquisition or retention of property by one person unconscionable against another suffices generally to ground equitable relief in the form of the declaration and enforcement of a constructive trust, *and the courts are careful not to limit the rule or the scope of its application by a narrow definition of fiduciary or confidential relationships protected by it. An abuse of confidence within the rule may be an abuse of either a technical fiduciary relationship or of an informal relationship where one person trusts and relies upon another, whether the relation is a moral, social, domestic, or merely personal one.*
>
> "The abuse of a confidential relationship by acquiring property through the employment of knowledge or interest obtained in such relationship constitutes a sufficient basis for equitable relief in the form of the declaration and enforcement of a constructive trust in respect of such property and in favor of the person wronged. The relationships of trustee and cestui que trust, principal and agent, client and attorney, and employer and employee, are striking, *but far from exclusive, examples of confidential relationships within the meaning of the rule.* * * *" (The italicized wording was italicized in the opinion for emphasis.)

What *MacDonald* v. *Follett* and *Fitz-Gerald* v. *Hull* settled was a question, on which there had been a diversity of opinion between the courts, of whether, in the absence of fraud, a constructive trust could be predicated on the

violation of an informal relation of trust and confidence, not amounting to a technical or formal fiduciary or confidential relation. Both decisions held that a constructive trust may be declared under facts showing a violation of relation of trust and confidence, whether it be a technical or formal fiduciary relation, or one arising from a domestic, social or personal relation, involving trust and confidence.

Have subsequent decisions "eroded" or modified *MacDonald* v. *Follett and Fitz-Gerald* v. *Hull*?

Petitioner appears to argue that subsequent decisions of the Supreme Court of Texas tend to "erode" and limit the decision in *MacDonald* v. *Follett* and *Fitz-Gerald* v. *Hull*, and asserts that:

> "While *MacDonald* v. *Follett* held that joint owners of interests in the mineral estate in Texas are not in a confidential relation 'by virtue of their being joint owners', it also held that the question of a confidential relation in that particular case was an issue of fact; and it was assumed by some that this meant in every constructive trust case. However, later decisions by the Texas courts indicated that except in formal fiduciary relations such as agent and principal, partner and partner, and the like, a confidential relation could not arise out of informal business relations where confidence was reposed unless there was evidence that the confidant has actually *agreed* to act for the confider (citing in footnote as authority—*Fitz-Gerald* v. *Hull*, supra, and *Omohundro* v. *Matthews*, 161 Tex. 367, 341 S.W.2d 401 (1960)."

Petitioner has misconstrued the holdings in *Fitz-Gerald* v. *Hull* and *Omohundro* v. *Matthews* when he cites them as authority for his statement that they hold "a confidential relation could not arise out of informal business relations where confidence was reposed unless there was evidence

that the confidant had actually agreed to act for the confider". Neither of these cases make such a holding. Both did involve evidence that one party had orally promised to take and hold title to property, in which all parties were jointly interested in acquiring, but violated his parol promise and took title in his own name. In each case, however, the court held that the trust did not arise because there was such a parol promise.

In *Fitz-Gerald, supra,* the court, in this connection, said:

> "This trust arose not because there was any agreement for the title to be taken in the name of Petitioner, and the property to be held by him in trust for the respondents."

In *Omohundro, supra,* the Court said (after quoting from *Fitz-Gerald, supra*):

> "So here, the Court is not enforcing the parol agreement. It is enforcing a constructive trust arising by operation of law to prevent unjust enrichment obtained through the violation of a fiduciary relationship."

Further, the Court said:

> "Constructive trusts have been held to apply where there have been oral promises or in spite of oral promises."

In many cases, involving oral promises or agreements to take and hold property, a constructive trust is imposed, but the decisions point out that the action is not based upon the oral promise or agreements, but upon the *violation* of a confidential or fiduciary duty or relation. Obviously, such an oral promise or agreement amounts to an "express trust" which is unenforceable, if merely oral, under the

provisions of *Section 7 of the Texas Trust Act and Statute of Frauds* which require "express trust" to be in writing, and no suit for specific performance could prevail. However, by means of the device of constructing a trust based not on the promise or agreement, but upon a violation of a status of trust and confidence, the same result is achieved. Almost invariably, in cases of this type passed upon by the Supreme Court of Texas, there have been dissents on the part of justices who, in short, hold to the premise that "an unenforceable oral contract cannot be the basis for a constructive trust". In both *Fitz-Gerald* and *Omohundro*, one justice dissented on this ground.

Petitioner cites *Gaines* v. *Hamman*, (June 1962) ..... Tex. ....., 358 S.W.2d 557, and says that the Supreme Court of the state in the case divided (5-1-3) on whether the evidence of such agreement was sufficient to create an issue of fact on the question of a confidential relation in a constructive trust case between a lease broker and a geologist. As a reference to the case will show, a majority of the Court rendered the decision, concurred in by six justices (one writing a separate concurrence), while three justices dissented. The question was whether there was sufficient evidence of probative force to create an issue of fact as to the existence of a relation of trust and confidence between the parties. The majority held there was, the dissenters to the contrary. There was testimony by the geologist of a general parol understanding with the broker, that he would furnish geological data on areas, and the broker would endeavor to obtain leases, and handle some with third parties, retaining overrides or other interests and account to the geologist for half of such reserved interests, after recouping the expenses incurred in the matter. The bone of contention between the majority of the Court, and the minority, was this parol understanding,

the minority holding it unenforceable as a violation of the Statute of Frauds.

It will be seen that none of these cases, cited by Petitioner, support the contention that an informal relation of trust and confidence cannot be a basis for the declaration of a constructive trust unless there is shown an actual agreement of the confidant to act for the confider. All of these cases reaffirmed the holdings in *MacDonald* v. *Follett* and *Fitz-Gerald* v. *Hull*.

Petitioner further cites the late case of *Thigpen* v. *Locke*, ... Tex. ....., 363 S.W.2d 247 (Dec. 1962). A full copy of the opinion is given in the *Petition for Writ of Certiorari, on page 19a as Appendix C*. There was a division of the Supreme Court on this decision, with the Chief Justice and two associate justices dissenting. Respondents do not belabor a discussion of the decision, as the opinions, affirming and dissenting, are before the Court in the Petition for Writ. It is obvious, however, that this is purely a case where the majority of the court found the evidence as to the existence of a relation of trust and confidence was insufficient to ground the imposition of a constructive trust, while the minority held the evidence was sufficient to raise an issue of fact to be determined by the trier of the facts. In short, what the majority held, stated in the language of its opinion, was:

> "* * * we hold that in the case there is not such evidence of justifiable trust and confidence as will create a fiduciary relationship."

The opinion added:

> "Our holding in no way detracts from the principle that a relationship of trust and confidence may be shown to arise informally from purely personal relationships. All we hold is that respondents do not

testify to facts—other than their own subjective feelings—which show that their relationship with Thigpen was anything more than a debtor-creditor relationship."

It will be seen that the decision in *Thigpen* v. *Locke* in nowise detracts from, or "erodes", *MacDonald* v. *Follett* or *Fitz-Gerald* v. *Hull*, or the principles of law applicable to constructive trusts enunciated therein. The majority opinion cites *Fitz-Gerald* v. *Hull*, and so does the dissenting opinion. The decision illustrates the fact that the learned justices of the Supreme Court of Texas, in evaluating the sufficiency of the evidence in a given case, do not indulge in a game of "follow the leader," but, on the contrary, each exercises his independent thinking in determining the evidentiary question, and there happens with some degree of frequency, as happens in all matters involving human judgment, conflicting conclusions as to the sufficiency of the facts to establish a cause of action. Such conflicting conclusions, involving only the facts, do not work any alteration of legal principles.

Criteria for Determining What Is the Local Law

Petitioner asserts there is a four dimensional conflict between the standards used by the Court of Appeals in determining what the state law is in a diversity case. It cites the Second Circuit as following "prophetic judgment"; the Eighth and Sixth Circuit using "persuasive data" test; the Fifth Circuit as adopting a "rigid" rule, refusing "to weigh the degree of authority belonging to a precedent by its agreement with the spirit of the times." Petitioner states its belief that the rule of the Second Circuit, as set out in *Cooper* v. *American Airlines, Inc.*, 149 F.2d 355, 359, which has been dubbed the exercise of "prophetic judgment," is the correct rule. Under the rule, Petitioner proceeds to "prophesy" that "the decision of the particular

judges" now constituting the Supreme Court of Texas would not have found a confidential relation or created a constructive trust in the instant case. It bases this prediction on the decision rendered by the majority in *Thigpen* v. *Locke*. As before stated, the *Thigpen* case was decided on the facts. The lower court had instructed a verdict in favor of Thigpen, on appeal, the Court of Civic Appeals reversed the decision, stating there was evidence of probative force in the record to require the submission of the question of a confidential relation to the jury. On writ of error to the Supreme Court of the State, the majority held that there was not "evidence of justifiable trust and confidence as will create a fiduciary relationship." This is but another way of saying it found there was no evidence of probative force in the record to sustain a finding of a relation of trust and confidence, upon which a constructive trust could be declared. In arriving at this conclusion, the majority stated it considered the evidence "as a whole and most favorably to the respondents." It was simply a holding that the evidence, so considered, presented no issue of fact as to the existence of a confidential relation. It in nowise effected, or sought to make, an exception to the substantive law of the State, with reference to constructive trust, as enunciated in *MacDonald* v. *Follett* and *Fitz-Gerald* v. *Hull*.

The cases which Petitioner cites, which seek to formulate a standard or test to be observed in determining the substantive law of a state in a diversity case, are all cases where there is doubt, confusion and conflicting pronouncements in the decisions of state, as to just what the law is. We find no such uncertainty and conflict, as to the substantive law of Texas applicable to the case at bar. It is clearly set out in *MacDonald* v. *Follett* and *Fitz-Gerald* v. *Hull*, and the last is cited and quoted in

both the majority and dissenting opinions in *Thigpen v. Locke;* and the first is quoted and discussed in the dissenting opinion. These two leading cases, as heretofore pointed out, in brief, lay down the rule that a constructive trust may be imposed where there is a relation of trust and confidence respecting business or property, and it is immaterial whether the relation of trust and confidence is a technical or formal fiduciary or confidential relation, or one arising from informal, social, domestic or personal relationship. No subsequent decision of the Supreme Court of Texas has been found by Respondents, and none has been cited by Petitioner that changes this pronouncement of substantive law.

CONCLUSION

Respondents have refrained from detailed discussion of the facts, which would tend unduly to extend this reply. The district court set out in all essential particulars, the facts as found by it, in the Memorandum Decision. The United States Court of Appeals, in its *per curiam* affirmance, expressed agreement with the district court's decision, as well as with the reasons assigned for it. Thus the facts have been resolved, and are not subject to revision "unless clearly erroneous", as set out in Rule 52(a) F. R. C. P. Though Petitioner asserts there is no evidence other than the "subjective" testimony of McKnight of the existence of a relation of confidence and trust between Petitioner and Respondents, yet the record shows the testimony of Welch, district landman for Petitioner, who gave evidence of a long standing relation between the parties, in which Petitioner reposed special confidence in McKnight, permitting him to deal for it, without signing a written contract which was required of all of its lease

buyers in the area. Apart from McKnight, Welch's testimony alone would have sufficed to support the court's finding that a relation of trust and confidence existed between the parties.

The testimony regarding the understanding and transaction entered into by Petitioner and Respondents in acquiring the oil and gas lease of 1952, under which Petitioner took the "deep rights", and Respondents the "shallow rights", and their dealings and course of action thereafter in maintaining their rights by payment of annual rentals, and then the circumstances by which Petitioner took a renewal lease in 1957, three months before the expiration of the prior lease, and which it now seeks to hold not only as to the "deep rights", but also as to the "shallow rights" held under the former lease by Respondents; all this evidence strongly supported the facts as found by the Court, and gave ample ground for the declaration of a construction in favor of Respondents with respect to the "shallow rights" under the renewal lease of 1957, and in decreeing restitution to Respondents of their rights under the previous lease, jointly owned by the parties.

Petitioner says this is inequitable; that it results in unjust enrichment of Respondents. In a footnote (p. 15 of Petition for Writ) it states: "The land in controversy is now producing oil from horizons above 6500 feet with recoverable reserves estimated at several hundred thousand dollars." This statement is completely outside the record as there was no evidence of such fact at the trial. Nevertheless, the statement is true as to the production of oil from horizons above 6500 feet. But it should be explained that such production comes from a well drilled after the suit was filed by agreement of both Petitioner and Respondents. There was never any production from the "shallow depths" before the filing of suit.

It will be observed that as to Petitioner's claim that the court's decision results in unjust enrichment of Respondents, Petitioner puts the cart before the horse. It would be Petitioner who would become unjustly enriched if the court had reached a contrary decision.

Respondents, having pointed out the want of merit in the Petition for Writ of Certiorari, respectfully pray that it be denied.

Respectfully submitted,

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CERTIFICATE OF SERVICE

I, William M. Steger, one of the attorneys of record for Respondents herein, and a member of the Bar of the Supreme Court of the United States, hereby certify that on the 19 day of March, 1963, I served copies of the foregoing Respondents' Reply to Petition for Writ of Certiorari to the United States Court of Appeals for the Fifth Circuit, by mailing to R. H. Whilden and W. G. Winters.

Jr., attorneys of record for Petitioner, each a copy of such reply, by first class mail, with postage prepaid, in envelopes duly addressed to said attorneys, at Post Office Box 2099, Houston, Texas.

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